PROTECTO MANUFACTURING COMPANY

Government Confidential

On February 10, 199X, an Air Force Contracting Officer received an urgent purchase request for six hundred (600) Quick Destruct Kits to be used in Special Weapon Systems. Delivery of the completed kits are required at the rate of 100 per week commencing July 1, 199X. The estimated production lead time is three months. **Failure to effect delivery as scheduled will have a critical impact on potential combat operations therefore this delivery schedule is mandatory.**

This acquisition is the first production run of the Quick Destruct Kit, although a prototype unit has been developed and satisfactorily tested by the Protecto Manufacturing Company. No other contractor possesses the detailed knowledge of the Destruct Kit and the experience necessary to accomplish the work in accordance with the established delivery schedule to meet the urgency of the operational requirements. The Contracting Officer requested and received approval to negotiate a contract award. As a result of these circumstances, the Contracting Officer discussed the requirement by telephone on February 15. Five days later Protecto Manufacturing Company provided a formal RFP on February 20, 199X. Negotiations will take place on March 20, 199X.

Due to the critical delivery schedule requirement the Contracting Officer indicated to Protecto that she intends to include a Liquidated Damages clause and provision in the contract for payment of $100 per unit for each day delivery is delinquent.

Because Protecto was able to produce a satisfactory prototype model that met all test specifications, the Contracting Officer has determined that enough cost information has been gained during the development phase to negotiate a Firm-Fixed Price contract.

Protecto submitted the following proposal on March 12 in response to the RFP:

(Extracted from Protecto Proposal)

Purchased Parts	$110,000	
Subcontracts	165,000	
Raw Material	60,000	
Other Costs (Liquidated Damages)	126,000	
Direct Mfg. Labor	75,000	
Mfg. Overhead (200% of DLC)	150,000	
Total Mfg. Cost	686,000	
G&A @ (10% of TMC)	68,600	
Total Cost	754,600	
Profit @ (16.7%)	126,018	
Total	$880,618	or $1,467.70 per unit

Audit and review indicate that the proposed costs and overhead rates are considered fair and reasonable except for the following:

A. Purchased Parts

Protecto's costs for purchased parts are based upon vendor quotes and catalog prices. Included in this cost item is the purchase of 50 pounds (a mill run lot) of a specialized copper wire at $125 a pound. From the bill of materials, even with normal spoilage, it is apparent that only 35 pounds of the wire are needed in the performance of this contract. However, the supplier requires an order of a mill run lot, not just 35 pounds, since it indicates that it has no market for the remaining 15 pounds of specialized wire.

Further checking reveals that the only other potential supplier of the wire is a small business that is a manufacturer of specialized wire and cable. This supplier has the copper wire on hand in the plant, ready for shipment, and is willing to provide the required 35 pounds of wire at $105 per pound. However, the employees of this vendor are on strike. The Contracting Officer contacted her Industrial Relations Specialist about the strike and was informed that it appears that the strike should be over in about two weeks.

B. Subcontracts

It was noted from the review of subcontracts that one critical item required nickel-plating of a component. Due to the tight specifications on the completion of this item, it is considered to be the pacing component in meeting the delivery schedule stipulated in the RFP. As a result, the contractor has split the requirement of 600 units equally (200 each) among three qualified vendors. In discussing this with the contractor's production personnel they indicated that they require three sources to insure absolutely that they will have the necessary components to meet the delivery requirements. The prices by the three vendors are as follows:

Subcontractor A	$250 per unit x 200	= $50,000
Subcontractor B	$275 per unit x 200	= $55,000
Subcontractor C	$300 per unit x 200	= $60,000

Protecto has included in their cost an average cost of $275 per unit.

While the Contracting Officer and Engineer both agree that plating this particular item to the finish specifications is absolutely necessary, they feel that Subcontractor A could probably supply Protecto's total requirements within the required time frame at a reduction in cost of $15,000.

C. Liquidated Damages

This item of cost is the major concern. The Contracting Officer contacted the Protecto contract administrator and was informed that because of the Liquidated Damages clause and the risk involved, Protecto had no alternative but to protect themselves by adding this cost to their proposal. Protecto further stated that the clause was not needed because top management has already indicated that they would do everything possible to make delivery on time as their performance on this contract would certainly receive special recognition in future acquisitions.

D. Profit

Profit, of course, is still a negotiable item.

Requirement: Negotiate a firm fixed price contract that ensures timely delivery of this critical item.

GENERAL PROVISIONS

SUBPART 12.2 -- LIQUIDATED DAMAGES

12.201 General

This subpart provides policies and procedures for the use of liquidated damages clauses in solicitations and contracts for supplies, services, and construction, entered into by formal advertising or negotiation.

12.202 Policy

(a) Liquidated damages clauses should be used only when both (1) the time of a delivery or performance is such an important factor in the award of the contract that the Government may reasonably expect to suffer damage if the delivery or performance is delinquent, and (2) the extent or amount of such damage would be difficult or impossible to ascertain or prove. In deciding whether to include a liquidated damage clause in a contract, the contracting officer should consider the probable effect on such matters as pricing, competition, and the costs and difficulties of contract administration.

(b) The rate of liquidated damages used must be reasonable and considered on a case-by-case basis since liquidated damages fixed without any reference to probable actual damages may be held to be a penalty, and therefore unenforceable. The contract may also include an overall maximum dollar amount or period of time, or both, during which liquidated damages may be assessed, to ensure that the result is not an unreasonable assessment of liquidated damages.

(c) The contracting officer shall take all reasonable steps to mitigate liquidated damages. If a liquidated damages clause is included in a contract and a basis for termination for default exists, the contracting officer should take appropriate action expeditiously to obtain performance by the contractor or to terminate the contract (see Subpart 49.4). If delivery or performance is desired after termination for default, efforts must be made to obtain the delivery or performance elsewhere within a reasonable time. Efficient administration of contracts containing a liquidated damages clause is imperative to prevent undue loss to defaulting contractors and to protect the interests of the Government.

(d) If a contract provides for liquidated damages for delay, the Comptroller General, on the recommendation of the head of the agency concerned, is authorized and empowered by law to make a remission, that in the discretion of the Comptroller General is just and equitable, of the whole or any part of such damages.

52.212-4 Liquidated Damages – Supplies, Services, or Research and Development

As prescribed in 12.204(a), the contracting officer may insert the following clause in solicitations and contracts when a fixed-price contract is contemplated for supplies, services, or research and development (see 12.202):

LIQUIDATED DAMAGES -- SUPPLIES, SERVICES, OR RESEARCH AND DEVELOPMENT (APR 1984)

(a) If the Contractor fails to deliver the supplies or perform the services within the time specified in this contract, or any extension, the Contractor shall, in place of actual damages, pay to the Government as fixed, agreed, and liquidated damages, for each calendar day of delay the sum of ....[Contracting Officer insert amount.]

(b) Alternatively, if delivery or performance is so delayed, the Government may terminate this contract in whole or in part under the Termination for Default -- Supplies and Services clause in this contract and in that event, the Contractor shall be liable for fixed, agreed, and liquidated damages accruing until the time the Government may reasonably obtain delivery or performance of similar supplies or services. The liquidated damages shall be in addition to excess costs under the Termination clause.

(End of clause)
(R 7-105.5 1969 AUG)

Fixed-Price Supply and Service Clause

NOTE: For your information the appropriate sections of the Default (Fixed-Price Supply and Service) clause referenced above are as follows:

(c) Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

(d) If the failure to perform is caused by the default of a subcontractor at any tier, and if the cause of the default is beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be liable for any excess costs for failure to perform, unless the subcontracted supplies or services were obtainable from other sources in sufficient time for the Contractor to meet the required delivery schedule.

PROTECTO MANUFACTURING COMPANY

Contractor Confidential

On the fifteenth of February 199X, the Protecto Manufacturing Company received a telephone call from an Air Force Contracting Officer concerning an urgent Air Force need for six hundred (600) Quick Destruct Kits to be used in Special Weapon Systems. This telephone conversation was followed by a formal RFP dated February 20th and received by Protecto on February 24th. The RFP called for delivery of the completed kits at the rate of 100 per week commencing July 1, 199X. The estimated production lead time is three months.

Because the timely acquisition of this product is important, the government wants to include a Liquidated Damages clause in the contract with a provision for the payment of $100 per unit for each day delivery is delinquent.

Although a prototype unit has been developed and satisfactorily tested by the Protecto Manufacturing this acquisition is the first production of the Quick Destruct Kit. No other contractor possesses the detailed knowledge of the Destruct Kit and the necessary experience to accomplish the work in accordance with the established delivery schedule. Negotiations are scheduled to take place on March 20, 199X.

The Contracting Officer indicated that because the company had been able to produce a satisfactory prototype model that met all test specifications, enough cost information had been gained during the development phase to negotiate a Firm-Fixed Price contract.

The following proposal was submitted on March 12:
(Extracted from Protecto Proposal)

Purchased Parts	$110,000	
Subcontracts	165,000	
Raw Material	60,000	
Other Costs (Liquidated Damages)	126,000	
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Total Cost	754,600	
Profit @ (16.7%)	126,018	
Total	880,618	or ($1,467.70 per unit)

The government auditor indicated that the Protecto cost element estimates and proposed overhead rates are considered reasonable except for the following:

A. Purchase Parts

The costs for purchased parts are based upon vendor quotes and catalog prices. Included in this cost item is the purchase of 50 pounds (a mill run lot) of a specialized copper wire at $125 a pound. From the bill of materials, even with normal spoilage, it is clear that only 35 pounds of the wire are needed in the performance of this contract. However, the supplier requires an order of a mill run lot, not just 35 pounds, because there is no market for the remaining 15 pounds of specialized wire.

Further checking reveals that the only other potential supplier of the wire is a small business that is a manufacturer of specialized wire and cable. This supplier has the copper wire on hand in the plant, ready for shipment, and is willing to provide the required 35 pounds of wire at $105 per pound. However, the employees of this vendor are on strike. The President of Protecto contacted the struck supplier and was informed that the strike could be over in about two weeks.

B. Subcontracts

One critical specification requires nickel-plating of a component. This specification is considered to be the pacing component in meeting the delivery schedule stipulated by the RFP. As a result, the requirement of 600 units is split equally (200 each) among three qualified vendors. In discussing this with the Contracting Officer, we indicated that we require three sources to absolutely insure that the necessary components are available to meet the delivery requirements. The prices quoted by the three vendors were as follows:

Subcontractor A	$250 per unit x 200	= $50,000
Subcontractor B	$275 per unit x 200	= $55,000
Subcontractor C	$300 per unit x 200	= $60,000

We have included in our cost an average cost of $275 per unit.

C. Liquidated Damages

The Government has strongly questioned the $126,000 we included in our proposal for liquidated damages. We have strongly indicated that because of the risk involved with such a requirement we have no alternative but to protect ourselves by adding this cost. Assuming our schedule is off by just 1 day, the company could lose $60,000 (600 X $100).

We have also informed the Government that we felt that the Liquidated Damages clause in the contract was not needed because our top management has already declared that all steps are to be taken to insure timely delivery since such performance will certainly receive special recognition in future Government acquisitions. **Under no circumstances will we accept the liquidated damages clause as it now reads unless Protecto Corp receives the $126,000 in other costs as a contingency fee. But we would remove the $126,000 if the Liquidated Damages Clause was removed or reduced to an insignificant amount.**

D. Profit

We feel that this is a high risk contract and therefore are proposing 16.7% profit.

GENERAL PROVISIONS

SUBPART 12.2 -- LIQUIDATED DAMAGES

12.201 General

This subpart provides policies and procedures for the use of liquidated damages clauses in solicitations and contracts for supplies, services, and construction, entered into by formal advertising or negotiation.

12.202 Policy

(a) Liquidated damages clauses should be used only when both (1) the time of delivery or performance is such an important factor in the award of the contract that the Government may reasonably expect to suffer damage if the delivery or performance is delinquent, and (2) the extent or amount of such damage would be difficult or impossible to ascertain or prove. In deciding whether to include a liquidated damage clause in a contract, the contracting officer should consider the probable effect on such matters as pricing, competition, and the costs and difficulties of contract administration.

(b) The rate of liquidated damages used must be reasonable and considered on a case-by-case basis since liquidated damages fixed without any reference to probable actual damages may be held to be a penalty, and therefore unenforceable. The contract may also include an overall maximum dollar amount or period of time, or both, during which liquidated damages may be assessed, to ensure that the result is not an unreasonable assessment of liquidated damages.

(c) The contracting officer shall take all reasonable steps to mitigate liquidated damages. If a liquidated damages clause is included in a contract and a basis for termination for default exists, the contracting officer should take appropriate action expeditiously to obtain performance by the contractor or to terminate the contract (see Subpart 49.4). If delivery or performance is desired after termination for default, efforts must be made to obtain the delivery or performance elsewhere within a reasonable time. Efficient administration of contracts containing a liquidated damages clause is imperative to prevent undue loss to defaulting contractors and to protect the interests of the Government.

(d) If a contract provides for liquidated damages for delay, the Comptroller General, on the recommendation of the head of the agency concerned, is authorized and empowered by law to make a remission, that in the discretion of the Comptroller General is just and equitable, of the whole or any part of such damages.

CONTRACT CLAUSES AND SOLICITATION PROVISIONS

52.212-4 Liquidated Damages – Supplies, Services, or Research and Development

As prescribed in 12.204(a), the contracting officer may insert the following clause in solicitations and contracts when a fixed-price contract is contemplated for supplies, services, or research and development (see 12.202):

LIQUIDATED DAMAGES --SUPPLIES, SERVICES OR RESEARCH AND DEVELOPMENT (APR 1984)

(a) If the Contractor fails to deliver the supplies or perform the services within the time specified in this contract, or any extension, the Contractor shall, in place of actual damages, pay to the Government as fixed, agreed, and liquidated damages, for each calendar day of delay the sum of ....[Contracting Officer insert amount.]

(b) Alternatively, if delivery or performance is so delayed, the Government may terminate this contract in whole or in part under the Termination for Default -- Supplies and Services clause in this contract and in that event, the Contractor shall be liable for fixed, agreed, and liquidated damages accruing until the time the Government may reasonably obtain delivery or performance of similar supplies or services. The liquidated damages shall be in addition to excess costs under the Termination clause.

(End of clause)
(R 7-105.5 1969 AUG)

Fixed-Price Supply and Service Clause

NOTE: For your information the appropriate sections of the Default (Fixed-Price Supply and Service) clause referenced above are as follows:

(c) Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

(d) If the failure to perform is caused by the default of a subcontractor at any tier, and if the cause of the default is beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be liable for any excess costs for failure to perform, unless the subcontracted supplies or services were obtainable from other sources in sufficient time for the Contractor to meet the required delivery schedule.